



Consumer Federation of America



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The Honorable Richard H. Baker
Chairman, Subcommittee on Capital Markets,
Securities and Government Sponsored Enterprises
United States House of Representatives
Washington, D.C. 20515

Subject: Housing Finance Regulatory Improvement Act -- H.R. 3703

Dear Chairman Baker:

The Consumer Federation of America¹ and Consumers Union² understand that comments are being solicited by the Subcommittee on Capital Markets, Securities and Government Sponsored Enterprises in anticipation of a summit to discuss the function of Government Sponsored Enterprises (GSE's) and H.R. 3703, the *Housing Finance Regulatory Improvement Act*.

We appreciate the Chairman's effort in calling for a forum that will provide interested parties with an opportunity to engage in a meaningful dialogue on the issues raised in H.R. 3703. The GSE's play a role in consumers' access to mortgages, the affordability of those loans, the availability of related products and services, and consumer protections in the marketplace. Because changes to the GSE's function could directly affect consumers, we request to participate in the September summit.

Overview

The Consumer Federation of America and Consumers Union appreciate the complexity of issues related to the GSE's. Our main goal is to help ensure that consumers continue to have access to affordable mortgages in a marketplace that is prone to fluctuations. Such fluctuations obviously can have a negative effect by driving up interest rates or other costs associated with getting a mortgage, restricting access to qualified borrowers, and keeping consumers locked in the subprime market. In addition to stabilizing the mortgage market, we also believe that the GSE's play an important role in checking predatory lending practices.

¹ The Consumer Federation of America is the nation's largest consumer advocacy group, composed of over two hundred and forty state and local affiliates representing consumer, senior, citizen, low-income, labor, farm, public power and cooperative organizations, with more than fifty million individual members.

² Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of *Consumer Reports*, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports* with approximately 4.5 million paid circulation, regularly, carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

It is appropriate for Congress to examine all institutions that receive direct or implicit public support or other benefits as a result of their status. That examination should evaluate whether consumers receive any benefits in return for the public backing of such institutions. In the case of the GSE's, it is especially important to ensure that the needs of less affluent populations are being adequately served. It is also appropriate to examine the effectiveness of the regulators in ensuring that the GSE's social mission, as defined in their charters, is carried out. It is prudent to ensure that the GSE's remain safe and sound.

GSE's Have Provided Important Benefits To Consumers:

Affordable Mortgages

The GSE's have done much to improve consumers' access to mortgage credit in this country. In the past several years, homeownership rates have increased to 67 percent, the highest level in the history of this country. Most agree that the GSE's have played an important role in this expansion by lowering mortgage costs, ensuring that consumers have access to innovative mortgage products, and providing an ample supply of affordable mortgage credit.

The GSE's have created new, innovative products, like low-down-payment mortgages. These types of products benefit consumers. The GSE's have also assisted consumers by opening up the underwriting and credit scoring process. This transparency will help consumers make fiscally sound financial decisions that could ultimately lower the cost of their mortgages.

The GSE's were among the first to recognize that some lenders were forcing borrowers to pay for higher cost loans when those borrowers actually qualified for lower cost products. The GSE's found that a significant number of homebuyers in the subprime market -- as much as 30% -- were placed in higher priced loans when they actually qualified for lower rate and less costly loans. In response, the GSE's have recently developed tools to help ensure that consumers get loans for which they are eligible. In addition, the GSE's have made a commitment that they will not purchase loans from lending institutions that do not report positive credit payment histories to the credit bureaus. Such responsiveness to failures in the marketplace is indicative of the role that the GSE's can play.

The GSE's continue to keep the mortgage marketplace stable, thereby assuring consumers have access to affordable mortgage loans. While a review of the regulatory oversight and operations of the GSE's during a period of relative prosperity may be worthwhile, it would be shortsighted not to consider the function of the GSE's during a period of economic downturn. It is precisely because credit tightens during market downturns that Congress created the GSE's. Continued access to affordable and stable mortgage loans is vital to the financial well being of all consumers.

Consumer Protections

The GSE's have played a continuing role in protecting and educating consumers. The GSE's have been especially responsive to concerns about predatory lending. The GSE's have already agreed not to purchase loans with predatory characteristics. They have announced that they will not

purchase loans with prepaid credit insurance, usurious interest rates and steep fees, or stiff prepayment penalties.

Consumer advocates will be watching closely to insure that these measures are well implemented, but these initial steps are a strong indication of the benefits that GSE's provide consumers. Many private mortgage lenders, on the other hand, have been slow to respond to the problem of abusive lending practices. In fact, many predatory practices continue today.

Because the GSE's have taken steps to protect consumers, the private mortgage lending industry may follow. It is questionable, however, whether the primary and secondary mortgage markets, acting on their own, would have developed similar products or adopted similar consumer protections and predatory lending principles so quickly, if at all.

Concerns About GSE's That Should Be Addressed:

Adequately Serving Less Affluent Populations

The GSE's have clearly made improvements in serving the less affluent, but an even greater effort is needed. More can be done to improve not only access to credit, but also the types of mortgage products available to consumers. The GSE's should do more to broaden access to affordable housing for low- and moderate- income Americans.

We concur with the testimony of John Taylor on behalf of the National Consumer Reinvestment Coalition during hearings on H.R. 3703 in regards to the role that the GSE's should play in serving the public. Specifically, we agree that it is important to expand access to affordable mortgages for minorities, new Americans, women and other underserved families and communities.

Ensuring Solvency

Ensuring solvency is an increasingly complex issue that should be overseen by experienced and competent regulators with adequate resources to fully scrutinize these large institutions for safety and soundness. We have reservations about whether the existing regulatory authority has adequate resources to fully evaluate the GSE's in this area.

The GSE's and their regulators must strike a balance between serving the less affluent and the solvency of the institutions. There is a tension that exists between wanting to control risk and wanting to provide even more lending to consumers to expand homeownership. A balance must be achieved between the risks inherent in the lending process and the fulfillment of the GSE's mission to ensure affordable housing and access to the resources needed to support the housing finance system.

Adequate Oversight and Regulation

Effective oversight is crucial to not only ensure that taxpayers are not exposed to unnecessary risks, but to ensure that the GSE's fulfill their mission to expand homeownership and stabilize the marketplace. While it may be worthwhile to explore ways to make the regulators more

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effective, the GSE's ability to function and to bring products to market within the scope of their mission should not be unnecessarily hindered. The structure and governance of the oversight authority must be carefully considered so that competing interests do not weight it down. Consumers could be harmed if products that could lower the cost of homeownership or improve market conditions were prevented from reaching the marketplace.

While scrutinizing the GSE's, it is important to remember that other financial institutions also receive direct or implicit subsidies from the federal government. The banking industry benefits from access to lower cost funds through access to the discount window, federal deposit insurance and a presumption by many that larger institutions are too-big-to-fail. At the very least, this presumption means that a bailout of larger banks if they hit hard times is just as likely as of GSE's.

The passage of the Gramm-Leach-Bliley Act will likely result in even larger mergers of large financial institutions than this country has seen over the past three years. The Act allows those institutions to engage in a wide variety of activities. These developments raise many of the same issues as those being addressed by your Committee regarding the GSE's. The operations of other taxpayer backed financial institutions warrant similar scrutiny by Congress. In the end, the potential bailout of any of these large financial institutions is ultimately left to the will of Congress and the regulators.

Conclusion

In conclusion, we appreciate your thoughtfulness on these complex issues. We agree that it is appropriate to examine the operations of the GSE's to ensure that they are fulfilling their mission, to make the oversight process better and more efficient, and to correct any deficiencies. It is precisely because the GSE's are more accountable to Congress and the American people than private lenders that we want to work with you to ensure that the oversight process is balanced and effective and that the GSE's continue to play a vital role in the marketplace.

It is crucial that consumers be able to count on getting affordable mortgage loans. Towards that end, it is important that the GSE's remain able to react to market fluctuations and to provide liquidity to consumers on a consistent basis. It is also important that the GSE's continue their work in curbing predatory lending practices.

We look forward to working with the Committee on this important matter and participating in the forum in September.

Sincerely,

Travis Plunkett
Consumer Federation of America

Frank Torres
Consumers Union